

STUX CAPITAL MANAGEMENT Manager Development Program I Exemption from Competitive Bidding

Background Information:

Stux Capital Management was funded through CalPERS' Manager Development Program I (MDP I). In February 2004, CalPERS allocated \$200 million to Stux' US large cap equity strategy. Stux was selected through CalPERS' partnership with Strategic Investment Management.

At its August 17, 1998 meeting, the Investment Committee approved the concept of a Manager Development Program (MDP) as a replacement for the then existing Small and Emerging Manager Program. The concept of the Manager Development Program is to provide venture capital and investment funds to emerging firms in exchange for a significant but minority equity stake in the selected firms. The program has a life of twelve years, at which point the MDP firms would either be elevated to CalPERS Mainstream program via the approved MDP Manager Transition Policy or terminated. The MDP managers are funded through the LLC partnerships, in which CalPERS is a limited partner.

Current Contractor can Competently and Expeditiously Perform the Services:

Stux has demonstrated the ability to provide consistent risk-adjusted returns since its inception into the Manager Development Program. Stux has outperformed its custom benchmark by 0.73% on an annualized basis for the five years ending April 30, 2011 and its risk-adjusted return (as measured by the Information Ratio) is 0.30. It has consistently outperformed its benchmark 15 of the 28 quarters since CalPERS' funding in February 2004. Stux is capable of completing the work expeditiously which it currently provides through the MDP I program. CalPERS has a history of working with Stux, which was selected into the MDP I program based on the firm's experience of key professionals and its ability to provide consistent excess returns.

Reasonable Fee:

CalPERS is paying a fixed fee both to Stux and to Strategic Investment Management for the assets currently being managed by Stux. As of April 30, 2011, Stux managed \$500 million for CalPERS. This proposed contract would reduce the current fee paid to Stux and would eliminate additional fees that CalPERS would be subject to if the assets remained in the MDP I program under the Strategic relationship. A reduced fee will not affect Stux' capability of

maximizing returns for CalPERS. The new fee schedule will incorporate a performance incentive, thus allowing CalPERS to pay only for performance.

Best Business Practice:

A CalPERS Best Business Practice can best be defined as an action that meets the Board's fiduciary duties to: (i) ensure the prompt delivery of benefits and related services to CalPERS' members and beneficiaries; (ii) maximize investment returns while minimizing the risk of loss, and (iii) defray reasonable expenses of administering the system.

Ensure prompt delivery of benefits and related services:

The prompt delivery of benefits and related services to CalPERS members and beneficiaries will continue by virtue of retaining the relationship with Stux Capital Management as a domestic long-only equity manager. The MDP I program consisted of both pure start-ups and more established firms. Conducting a solicitation throughout the MDP I program would not be feasible given Stux is the last remaining firm in the program. Due to the diversity of asset classes and the fact that firms may be ready to transition at different times, staff believes the current solicitation process would not be the most efficient method for the MDP program. Additionally, Stux has been evaluated on a similar level to the RFP process prior to its selection into the MDP I program and since has developed a proven successful track record of managing CalPERS' assets. An exemption would allow staff an outlet to more efficiently transition the assets out of the MDP I program and into CalPERS active mainstream external manager program. This method will ensure that Stux can continue to manage assets uninterrupted, therefore continuing to add value for CalPERS, as proven by their consistent outperformance since inception in February 2004.

Maximize investment returns while minimizing risks:

Stux Capital Management has been managing CalPERS' assets since their inception date of February 2004 and, as of April 31, 2001, has added value in each calendar year with the exception of the market crash of 2008 which was an extremely difficult year for all active management. Retaining a relationship with Stux via the award of a direct contract would enable CalPERS to continue to maximize returns while minimizing loss as proven by Stux' ability to provide consistent outperformance and low volatility. This is further illustrated in Tables 1 and 2 of the June 13, 2011 Investment Committee agenda item.

Defray reasonable expenses of administering the system:

Stux Capital Management is currently managing CalPERS' assets through the MDP I program. The proposed process would help defray reasonable expenses of administering the system by allocating additional assets directly to Stux rather

than through the MDP partnership. Given Stux is the last remaining firm in MDP I, this process would be a less expensive solution than conducting a lengthy solicitation process or than keeping Stux in the MDP I program and thus continuing the costs of administering the program by keeping the program open. As mentioned under the reasonable fee section, this process would also reduce the current fees paid to Stux and eliminate the fees paid to the MDP partnership. An exemption would allow staff to more expediently and efficiently transfer the assets between accounts, thus reducing associated transition costs.

Summary

Based upon the above criteria, the CalPERS Investment Office is requesting an exemption from competitive bidding for the following reasons: 1) there is a current contractor that is capable of performing the work competently and expeditiously; 2) the current contractor can do so at a reasonable fee; 3) the selection of the contractor is based on a best business practice decision.